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IN THE

Supreme Court of the United States

OCTOBER TERM, A. D. 1934.

No. 95.

CATHERINE LLEWELLYN VAN WART, By Roy M. Van Wart, Natural Tutor, *Petitioner*,

vs.

COMMISSIONER OF INTERNAL REVENUE, *Respondent*.

BRIEF FOR PETITIONER.

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October 22, 1934.

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BRIEF FOR PETITIONER.

I.

OFFICIAL REPORTS OF THE OPINIONS DELIVERED BELOW.

The opinion of the Circuit Court of Appeals for the Fifth Circuit (R. 23), is reported in 69 F. (2d) 299. The memorandum opinion of the Board of Tax Appeals (R. 14) is unreported.

II.

JURISDICTION.

The judgment of the Circuit Court of Appeals was entered on March 12, 1934 (R. 26). The petition for a writ of certiorari was filed on June 6, 1934, and was granted on October 8, 1934 (R. 29). The jurisdiction of this Court rests on Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925 (Section 347, Title 28, U. S. C.).

III.

STATEMENT OF THE CASE.

The sole question involved is whether an attorneys' fee, incurred and paid by a guardian in his fiduciary capacity, for conducting certain litigation which resulted in securing for the guardianship a substantial amount of income, is a business expense under Section 214 (a) (1) of the Revenue Act of 1924 and therefore deductible from gross income in the income tax return filed by the guardian for a minor child.

The facts are contained in a stipulation (R. 13) and in the decision of the Circuit Court of Appeals, Fourth Circuit, of *Van Wart v. Jones, et al.*, 295 Fed. 287, which decision by reference was made a part of said stipulation of facts.

Catherine Llewellyn Van Wart, a minor, was the beneficiary of a trust created by the will of her grandfather, Jenkins Jones, deceased. Her father, Roy McLean Van Wart, was appointed by the Civil District Court in New Orleans, Louisiana, as her natural tutor or guardian on May 6, 1921. Upon demand by the guardian for the income due the minor, the trustees under the will of Jenkins Jones took the position that the income of the trust was to be accumulated until the minor became of age, when she was to receive the corpus. Thereupon Roy Van Wart, as guardian, employed counsel and filed suit to compel the trustees to

distribute the income of the trust estate as currently earned. A favorable decree was finally entered by the Circuit Court of Appeals for the Fourth Circuit in *Van Wart v. Jones, et al., supra,* and accordingly the trustees in 1924 paid to Roy Van Wart, as guardian, accumulated income of $159,094.16 and thereafter paid to him the 1924 income of $80,241.68. Under authority of the Court appointing the guardian, an attorneys' fee of $30,000 was allowed and paid in 1924 by the guardian for services in this litigation.

In the income tax return for the year 1924, filed by Roy Van Wart as guardian of petitioner, the sum of $30,000 was claimed as a deduction from gross income. The respondent disallowed the deduction as not being a business expense, but on appeal to the United States Board of Tax Appeals petitioner's contention was sustained (R. 15). The Circuit Court of Appeals reversed the decision of the Board of Tax Appeals and held that the payment was an expense personal to the minor and therefore not deductible (R. 23). In so holding the Circuit Court held contrary to the decision of the Circuit Court of Appeals for the Second Circuit in *Commissioner of Internal Revenue v. Wurts-Dundas,* 54 F. (2d) 515, where under similar facts that Court held that the payment of attorneys' fees by the guardian was an expense incident to carrying on the business of administering the ward's estate and hence deductible as a business expense in the guardian's return.

IV.

SPECIFICATION OF ERRORS.

The petitioner intends to urge the errors that are specified on pages 5 and 6 of the petition for certiorari filed herein, namely:

1. The Circuit Court of Appeals erred in finding and holding that the expense of an attorneys' fee, incurred and paid by the guardian in his fiduciary capacity, was

an unallowable deduction upon the income tax return filed by the guardian.

2. The Circuit Court of Appeals erred in finding and holding that such expense was not an ordinary and necessary expense incurred by the fiduciary in carrying on the business of administering the guardianship matter.

3. The Circuit Court of Appeals erred in finding and holding that such expense was an unallowable personal expense of the minor child.

V.

SUMMARY OF ARGUMENT.

A—Statutes involved.

B—The guardian is by statute required to file the return and pay the tax. He, in his fiduciary capacity, is the taxpayer as distinguished from the ward.

C—The attorneys' fee paid by the guardian is an ordinary and necessary expense, incurred and paid by him in carrying on or administering the business of his guardianship. Being an expense of the guardian it cannot at the same time be a personal expense, incurred and paid by the ward.

D—The decision of the Court below is in conflict with *Commissioner of Internal Revenue v. Wurts-Dundas*, 54 F. (2d) 515, decided by the Circuit Court of Appeals, Second Circuit. It is also contrary to decisions of the Board of Tax Appeals and rulings of the Bureau of Internal Revenue.

VI.

ARGUMENT.

A—Statutes Involved.

Revenue Act of 1924, C. 234, 43 Stat. 254;

Sec. 214. (a) In computing net income there shall be allowed as deductions:

(1) All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered; * * * (c. 234, sec. 214, 43 Stat. 269).

Sec. 215. (a) In computing net income no deduction shall in any case be allowed in respect of—

(1) Personal, living, or family expenses (c. 234, sec. 215, 43 Stat. 271).

Sec. 219. (a) The tax imposed by Parts I and II of this title shall apply to the income of estates or of any kind of property held in trust, including—

* * * * * * * * * *

(2) Income * * * collected by a guardian of an infant which is to be held or distributed as the Court may direct;

(b) Except as otherwise provided in subdivisions (g) and (h), the tax shall be computed upon the net income of the estate or trust, and shall be paid by the fiduciary. * * * (c. 234, sec. 219, 43 Stat. 275.)

Sec. 200. (b) The term "fiduciary" means a guardian, trustee, executor, administrator, receiver, conservator, or any person acting in any fiduciary capacity for any person. (c. 234, sec. 200, 43 Stat. 254.)

Sec. 225. (a) Every fiduciary * * * shall make under oath a return for any of the following individuals, estates, or trusts for which he acts, * * *

(4) Every estate or trust the net income of which for the taxable year is $1000 or over;

(b) • • • Any fiduciary required to make a return under this chapter shall be subject to all the provisions of this chapter which apply to individuals. (c. 234, sec. 225, 43 Stat. 280.)

Sec. 2. (a) (9) The term "taxpayer" means any person subject to a tax imposed by this Act. (c. 234, sec. 2, 43 Stat. 254.)

B—The Guardian and not the Ward is the Taxpayer.

Under the heading "Estate and Trusts" of the 1924 Revenue Act, Section 219 (a) thereof imposes the tax upon "income of estates or of any kind of property held in trust," including (2) income "collected by a guardian of an infant which is to be held or distributed as the Court may direct." Under Section 219 (b) the tax shall be computed upon the net income of the estate or trust and "shall be paid by the fiduciary," and in Section 200 (b) the term "fiduciary" means "a guardian, trustee, executor, administrator, receiver, conservator, or any person acting in any fiduciary capacity for any person." By Section 225 (a) the fiduciary is charged with making the return and (b) of the same section makes him "subject to all the provisions of the Act which apply to individuals." Finally, Section 2 (a) (9) defines the taxpayer as "any person subject to a tax imposed by this Act."

In the face of these various provisions of the taxing Act, it is difficult to see how the Court below could reach the conclusion that this was not "the case of a trust estate of such character that the income derived therefrom is taxable to the fiduciary." The guardian is similar to any other trustee or fiduciary and is a "taxable person" as distinguished from his ward. *Merchants Loan & Trust Company v. Smietanka*, 255 U. S. 509 at 516. The guardian incurred and paid the expenses, not the ward. He, as fiduciary, was charged with filing the return and paying the tax.

The case of *Busch v. Commissioner*, 50 F. (2d) 800, cited by the lower Court as authority for its conclusion that the income was taxable to the ward, does not so decide as we read it. The Busch case held that one of the beneficiaries of a trust could not deduct in his personal return a part of the losses claimed and taxes paid by the trust, notwithstanding that he was both beneficiary and trustee thereof. The court there restated the principle which we urge, that a trust is an entity, entirely separate from its beneficiaries, citing *Merchants Loan and Trust Company v. Smietanka, supra.*

The aforesaid provisions of the Act make no distinction between a guardian and any other form of fiduciary. Each is charged with filing the return of *net* income, not *gross* income, the result of respondent's contention here, and paying the tax due thereon.

C—The Attorneys' Fee is a Necessary Business Expense of the Guardian.

Respondent must concede that the payment of the attorneys' fee was "an ordinary and necessary" expense, aside from the question whether it was a business or personal expense. The guardian was acting strictly in the discharge of his duty, and in fact had no alternative or discretion in the matter, once it was established that the trustees were withholding income from him in his fiduciary capacity. The law demanded that he take appropriate action to recover the income for his ward and the conduct of the resulting litigation, through the Circuit Court of Appeals, of necessity required the employment of competent counsel and payment of reasonable charges for services rendered. *Kornhauser v. United States*, 276 U. S. 145, 152; *Commissioner v. Wurts-Dundas*, 54 F. (2d) 515.

The only other requirement of Section 214 (a) (1) of the Act is that the payment made by the fiduciary be a "business" expense. We agree that the item of expense was in

no sense connected with Roy Van Wart's individual business or profession, and that the ward herself was engaged in no business. The question is whether or not administering this guardianship matter, involving as it did the procurement of substantial amounts of income for the trust, is in itself doing "business" within the meaning of the statute. No question arises as to the expense being a charge against the corpus of the estate. This is not that case.

"Business" has been defined by this Court in *Flint v. Stone Tracy Company*, 220 U. S. 107, 171, as "a very comprehensive term and embraces everything about which a person can be employed."

The record discloses that Roy Van Wart was duly appointed guardian and was therefore charged with the duty to conserve, protect and increase, if possible, the income of the minor; that acting in this fiduciary capacity he employed counsel and conducted protracted litigation; that he was successful in securing approximately $160,000 of accrued income for the benefit of his ward, as well as 1924 income of approximately $80,000; that under order of the Court he paid counsel from these funds $30,000.00 for services rendered; that as a fiduciary he filed an income tax return and paid the tax shown thereon. The Court will take judicial notice that the guardian is required to file accounts with and secure the approval of the Court which appointed him, whenever investing, reinvesting or disbursing any part of these substantial trust funds. All of these acts, we confidently assert, constitute the business of administering a guardianship and the payment of a necessary attorneys' fee by the fiduciary from trust income is an expense incident to that business and deductible for income tax purposes.

D—The Decision of the Lower Court is Contrary to the Decisions of the Circuit Court of Appeals for the Second Circuit and the Board of Tax Appeals, as Well as the Rulings of the Bureau of Internal Revenue.

The decision of the Court below is in direct conflict with the decision of the Second Circuit in *Commissioner v. Wurts-Dundas* (*supra*), where the facts were similar and the expense was allowed the guardian as a business deduction. Contrary to that decision, the Court below held that since the expense was paid from the ward's income, she must be treated like an adult taxpayer, who under similar circumstances would not be entitled to the deduction because it would be classed as a personal expense. In support of this conclusion the lower Court cites *Commissioner v. Field*, 42 F. (2d) 820, decided by the Second Circuit, and *Walker v. Commissioner*, 63 F. (2d) 351, decided by the Third Circuit. The *Field* case is clearly distinguished by the Second Circuit in its subsequent decision in the *Wurts-Dundas* case from which we quote at length, page 516:

> "We are told that this case is ruled by our decision in Commissioner of Internal Revenue v. Field, 42 F. (2d) 820. In that case, however, the beneficiary of a trust incurred expenses for attorneys' fees himself. He had no guardian. Field was not in agreement with the other trustees as to his own right to receive, after his brother's death, the portion of the corpus which had been left in trust for that brother. In his own behalf and for his own personal benefit, he employed and paid the attorneys the fees he sought to have deducted from his own gross income as a business expense. We held that the expense of attorneys' fees to Field of the securing by Field of a judgment which established his claimed right to the present unrestricted enjoyment of a portion of the trust estate was a personal expense which he incurred in protecting his own property and for which Congress had not seen fit to allow any deduction. But, where a guardian incurs reasonable and necessary expenses in securing the income to which it is entitled as guardian, it is acting wholly in its ca-

pacity as a fiduciary, and is carrying on the business of administering its ward's estate. The income received is the income which results from the guardian's conduct of that business, whatever may be the source of the income. The expenses of the guardian are the expenses of that business. In the end, of course, the ward gets the benefit, if any, and must bear the expense; but the statute in section 219 (b) of the 1921 act provides for the return of income by the guardian and in section 219 (d) requires distributable income to be included whether distributed or not, so that the guardian may be, and no doubt often is, required to include income as of a time before it reaches the ward and before it has actually been withdrawn from the business through which the special circumstances of the ward compel it to be received. *Unless the true status of the guardian is confused with that of a mere agent for the ward, it will be seen that the return of income filed by the guardian is to reflect as net income to the ward the remainder of gross income after deducting the ordinary and necessary expenses paid or incurred by the guardian in doing its work in securing for its ward the income the ward receives, remotely from whatever source, but directly from what the necessity for the guardianship has made the business of a guardianship.*" (Italics ours)

Respondent did not petition for certiorari in the *Wurts-Dundas* Case.

Similarly, *Walker v. Commissioner, supra,* decided that the beneficiary of a trust, who personally employed and paid attorneys, in a suit to surcharge her trustees for mismanagement, was not entitled to deduct her attorneys' fee as a business expense. The court merely held that she was not engaged in any trade or business and affirmed the decision of the Board of Tax Appeals (20 B. T. A. 937). Before the Board the beneficiary contended that she was entitled to the deduction because of previous Board decisions in favor of similar allowances to fiduciaries. The Board answered this contention as follows, pages 946-947:

"Those proceedings, however, related to the deduction of attorneys' fees paid by fiduciaries, and we based our decisions in the proceedings on the proposition that under the law it is the duty of fiduciaries to protect the interests and income of the estates committed to their care; that so far as such protection is a duty it is the business of the fiduciaries, and that therefore any expenses, including attorneys' fees, properly incurred are expenses incurred in carrying on a business. It is manifest, therefore, that the decisions referred to are not applicable to the facts of this proceeding."

The issue has also been presented in two other Circuit Court cases where the beneficiaries of trusts sought the deduction of attorneys' fees as a business expense. In each case the deduction was disallowed as being a personal expense incurred and paid by taxpayers in protecting their individual property. *Kenan, et al. v. Bowers,* 50 F. (2d) 112; *Lindley v. Commissioner,* 63 F. (2d) 807. In the *Lindley* case the court took occasion to distinguish the deduction allowed in the *Wurts-Dundas* decision in the following language, page 808:

"But it must be noticed that the expenses were in no sense personal and were incurred in the performance of a duty to obtain all income belonging to the guardianship."

The Board of Tax Appeals has consistently held that payment of attorneys' fees by a fiduciary to procure or produce income for the estate is a necessary business expense incurred in carrying on the business of the estate. *Grace M. Knox, Executrix v. Commissioner,* 3 B. T. A. 143; *Thomas H. Franklin, et al., Executors v. Commissioner,* 11 B. T. A. 148; *Florence Grandin v. Commissioner,* 16 B. T. A. 515; *Wurts-Dundas v. Commissioner,* 17 B. T. A. 881; *Margaret B. Sparrow et al., Trustees v. Commissioner,* 18 B. T. A. 1; *Chicago Title & Trust Co., et al., Trustees v. Commissioner,* 18 B. T. A. 395.

No appeal was taken by the Government from any of the above decisions with the exception of the *Wurts-Dundas* case, which, as previously stated, was affirmed.

The Bureau of Internal Revenue has repeatedly considered the deductibility of expenses in connection with the administration of estates. Commissions paid to executors and administrators and other proper expenses incident to the settlement of an estate, and incurred primarily with respect to the liquidation and distribution of assets, are properly held to be a direct charge against the corpus of the estate, and are therefore not deductible for income tax purposes. But where the fiduciary incurs expenses with respect to any current income which the estate might derive during the process of administration, such expenses are deductible as business expenses. In Office Decision 537, Cumulative Bulletin 2, page 176, in considering a similar section of the 1918 Revenue Act, it is stated:

> "The only provision in that section by virtue of which expenses of administration are deductible is the one providing for the deduction of expenses of *carrying on a trade or business*. Under a liberal construction of the language used it seems possible to hold that expenses having a reasonable, proximate relation to the *collection of income* due an estate are deductible." (Italics ours.)

Again in I. T. 2238, Cumulative Bulletin IV-2, page 50, the following language is used:

> "The relationship between committee and ward is analogous to that existing between *guardian and minor*. In either case the costs of the services of the fiduciary and the incidental expenses connected with the management of income-producing property or funds belonging to the *ward or minor*, or the *collection of any income* inuring to him, whether or not derived from the property under the control of the fiduciary, are essentially ordinary and necessary expenses incurred with respect to the income of such ward or minor, and *fulfill the requirements of Section 214 (a) 1.*" (Italics ours.)

Also, an attorneys' fee, paid by a guardian to secure his appointment to permit his receipt of income for the ward, has been held to be an ordinary and necessary business expense, deductible in the return filed for the ward (I. T. 2124, Cumulative Bulletin IV-1, page 138).

The court below seeks to differentiate between a guardian and other fiduciaries and would disallow the deduction because the expense is paid from income which eventually the ward will enjoy. To permit the deduction, the Court holds, would give the minor an unfair advantage as compared with an adult taxpayer to whom such an expense would be personal and not deductible.

We submit that the comparison should be between fiduciaries and not between a minor, who does not personally incur or pay the expense, and an adult taxpayer who receives his income direct and personally incurs and pays the attorneys' fee. If in the instant case, the beneficiary was of age and the trustees of the estate of Jenkins Jones had been compelled to institute suit to recover income due them from some third party, the expense of such litigation would be a proper deduction in the return filed by them. The beneficiary would pay a tax on the amount distributed to her. There should be no distinction between fiduciaries and plainly the sections of the Act, heretofore enumerated, intend none. To so hold will be in accord with the line of decisions of the Circuit Court of Appeals for the Second Circuit, the decisions of the Board of Tax Appeals, and the rulings of the Bureau of Internal Revenue.

We respectfully submit that the judgment in this case should be reversed.

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October 22, 1934.